CHEVRON U.S.A., INC.

IBLA 98-466 Decided April 12, 1999

Appeal from a Decision of the Associate Director for Policy and Management Improvement, Minerals Management Service, denying appeals from orders to correct royalty reports and pay additional royalty due. MMS-93-0700-OCS.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982--Oil and Gas Leases: Communitization Agreements--Oil and Gas Leases: Royalties: Generally--Royalties

Pursuant to the Federal Oil and Gas Royalty Management Act of 1982, a lessee or its designee of a lease in a unit or communitization agreement which contains only Federal leases with the same royalty rate and funds distribution shall report and pay royalties on oil and gas production for each production month based on the actual volume of production sold by or on behalf of that lessee. This requirement does not alter a lessee's liability for royalties on oil or gas production based on the share of production allocated to the lease in accordance with the terms of the lease, a unit or communitization agreement, or any other agreement.

2. Federal Oil and Gas Royalty Management Act of 1982--Oil and Gas Leases: Communitization Agreements--Oil and Gas Leases: Royalties: Generally--Royalties

The applicable regulation, 30 C.F.R. § 202.150(e), establishes that the full share of production from a unitized or communitized lease is subject to royalty payment and reporting, and provides a rule for valuing production in the situation in which a Federal or Indian lessee participating in approved unitization or communitization agreements takes less than its share of production attributable to its lease, and the production is actually taken by an agreement participant who is not the lessee of the Federal or Indian lease to which the production is allocated under the agreement. In such cases, the agreement participant who takes in excess of its allocated share is deemed a lessee only for purposes of determining the value of that excess production, which must be computed by reference to the actual circumstances of the sale or disposition and in accordance with the provisions of 30 C.F.R. Part 206.

3. Federal Oil and Gas Royalty Management Act of 1982--Oil and Gas Leases: Communitization Agreements--Oil and Gas Leases: Royalties: Generally--Royalties

The rule that the value of the production taken by the agreement participant in excess of its allocated share under the communitization agreement is to be calculated on the basis of the gross proceeds accruing to the agreement participant from the sale or disposition of the gas, as provided in 30 C.F.R. Part 206, does not affect a lessee's ultimate liability for the payment of royalties on its allocated share of communitized agreement production in accordance with the terms of relevant agreements among the parties.

4. Federal Oil and Gas Royalty Management Act of 1982--Oil and Gas Leases: Communitization Agreements--Oil and Gas Leases: Royalties: Generally--Royalties

Regulation 30 C.F.R. § 202.150(e)(4) does not state or require that royalty is to be paid on an entitlement basis. The regulation states only that if royalties are paid on the full share, then no royalties will be paid for subsequent takes that exceed the lessee's share.

5. Federal Oil and Gas Royalty Management Act of 1982--Oil and Gas Leases: Communitization Agreements--Oil and Gas Leases: Royalties: Generally--Royalties

In the absence of an executed agreement outlining an alternative method for establishing the value of production pursuant to 30 C.F.R. § 202.150, to which all payors must agree, MMS correctly requires all lessees of communitized Federal oil and gas leases to pay royalty on the same basis and according to the actual volumes of gas taken, rather than according to their respective entitlements. Lessees of unitized and communitized Federal oil and gas leases cannot pay royalty on production from the leases on both an entitlement and a takes basis.

APPEARANCES: Colleen B. Naff, Esq., Houston, Texas, for Appellant; Geoffrey Heath, Esq., Howard W. Chalker, Esq., Christopher P. Salotti, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE PRICE

Chevron U.S.A., Inc. (Chevron), has appealed 1/ from a January 10, 1997, Decision of the Associate Director for Policy and Management Improvement, Minerals Management Service (MMS), denying appeals from Orders dated July 14, 1993, from the Production Accountability Branch, Royalty Management Program (PAB/RMP), MMS, directing Chevron, Nortex Corporation (Nortex), and Pacific Enterprises Oil Company (Pacific) to amend royalty reports and pay any additional royalties due for gas from communitized leases. Chevron holds Federal Lease No. 030-024491-0, while Nortex holds Federal Lease No. 030-015035-0, both of which are subject to Communitization Agreement No. 794-001542-0 (CA) and are allocated production from the Supron Federal 14 Comm. No. 1 Well. 2/ Pacific held the

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1/ Although the Decision stated that a 30-day period would be granted to allow the three payors to reach an agreement, MMS did not transmit the Decision to Chevron. The record shows that MMS initially addressed the Decision incorrectly. The Decision was not mailed to Chevron until 18 months later, in June 1998, an occurrence that is not explained by MMS. (Appeal Transmittal memorandum dated Aug. 18, 1998; June 11, 1998, letter from MMS Appeals Division to Kenneth R. Cook at Chevron USA Production Company.) Chevron acknowledges that it received the MMS Decision on June 16, 1998, and this is confirmed by return receipt cards in the case file. Chevron's Notice of Appeal (NA) states that it was submitted on July 15, 1998, but it was not date-stamped by MMS until July 17, 1998. However, MMS has indicated its belief that the appeal was filed timely. (Appeal Transmittal memorandum dated Aug. 18, 1998.) The regulations require an appeal to be transmitted in time to be received within 30 days after the date of service of the decision appealed. 43 C.F.R. § 4.411(a). If an appeal is received after the grace period provided by 43 C.F.R. § 4.401(a), it will be dismissed. 43 C.F.R. § 4.411(c). The grace period afforded by the regulations provides that if the NA is not received in the proper office within the time required, the delay will be waived if the document was filed not later than 10 days after it was required to be filed and it is determined that it was transmitted or probably was transmitted before the end of the period in which it was required to be filed. 43 C.F.R. § 4.401(a). Given MMS' statement that the appeal was timely filed, we conclude that the appeal is timely. We note also that neither Pacific nor Nortex appealed the Decision, and Chevron does not purport to make any argument on their behalf.

2/ The CA comprises two tracts, each covering 50 percent of the area subject to the CA. Tract No. 1 is subject to Federal Lease No. 030-024491-0 and is owned in its entirety by Chevron. Federal Lease No. 030-015035-0 covers Tract No. 2, and according to the Nov. 18, 1994, Field Report at 2, is owned by Pacific. However, both the Associate Director and counsel operating rights to the leases from September 1990 to April 1993, and reported production from the CA in that capacity. Nortex was a royalty payor for both leases, whereas Pacific was a royalty payor for Federal Lease No. 030-015035-0 (Tract No. 2) and pursuant to 30 C.F.R. § 206.101 is thus deemed a lessee for royalty purposes. During the relevant period, Chevron took and sold virtually all of the CA's production, paying royalty only on the 50 percent of unit production to which it was entitled under the CA. Pacific and Nortex, however, paid royalty on the basis of their minimal takes.

MMS reviewed production reported and royalty payments attributable to the CA for 24 sales periods from October 1989 to July 1992 and discovered discrepancies between the sales volumes reported by Pacific to the Production Accounting and Auditing System (PAAS) and the monthly royalty reports submitted to the Auditing and Financial System (AFS) by the royalty payors. Pacific provided copies of gas balancing statements which showed that Chevron had reported sales on an entitlement basis rather than on the basis of actual takes. (November 18, 1994, Field Report prepared by the Compliance Verification Division of MMS, at 1.) On April 6, 1993, MMS requested an explanation from Chevron. (Attachment D to Field Report.) Chevron responded by confirming that it had paid royalty based upon entitlement, in accordance with company policy, and further advised that Pacific was responsible for the discrepancy. (Chevron Response dated May 19, 1993; Attachment E to Field Report; Field Report at 1.)

This prompted the PAB/RMP to issue the July 14, 1993, Orders to Report to the three payors. 3/ Those Orders directed them to file amended royalty reports to account for the reporting discrepancies and to pay any additional royalties determined to be due, and advised them that interest would be assessed on any additional royalties paid. Lastly, all the payors were informed that "[w]hen a Federal or Indian lease is underreported and agreement on reporting responsibility cannot be obtained, MMS will hold all established payors and the lessee(s) of record on the underreported lease responsible for the total volume discrepancy." (Order at 1.) All three payors timely appealed to the Associate Director.

The Field Report noted that Chevron was the only seller of lease production during most of the months at issue. (Field Report at 1.) Additionally, the Compliance Verification Division determined that Chevron appropriately had paid royalty based upon its entitlement, while Pacific

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fn. 2 (continued)
for MMS state that the lease is wholly owned by Nortex, which is consistent with the information reflected in a Bureau of Land Management case abstract, at least as of Jan. 24, 1994. Chevron's interest in the well is derived from the CA and its ownership of Federal Lease No. 030-024491-0. (Nov. 18, 1994, Field Report at 2.)

3/ The Order to Chevron pertained to both communitized leases, whereas the Orders to Pacific and Nortex pertained only to Federal Lease No. 030-015035-0. (Nov. 18, 1994, Field Report at 2.)

and Nortex had reported and paid royalty based upon their minimal actual takes. Concluding that Chevron had paid royalty in accordance with its Division Order, 4/ Operating Agreement and Gas Balancing Agreement, the Field Report recommended that Pacific and Nortex be required to pay the balance due for their entitled shares on 316,834 Mcf of gas produced. (Field Report at 3, 4.) In making this recommendation, it appears that the Field Report also relied on Mesa Operating Limited Partnership (On Reconsideration) (Mesa II), 128 IBLA 174 (1994). (Field Report at 3.)

In its Statement of Reasons (SOR) filed in support of the appeal to the MMS Director, Chevron framed the issue in terms of whether it is obligated to pay royalties on production that exceeds its entitled share, and whether this obligation includes a lease in which Chevron owns no interest. (SOR at 2.) It was argued that 30 C.F.R. §§ 202.150(e)(1) and (e)(4) require lessees of Federal and Indian leases which are subject to unitized or communitized agreements and who take less than their proportionate share of production to pay royalty on the basis of their full entitled share, and that such a requirement would not be necessary if royalties are to be paid on the basis of actual takes, as MMS contends. Chevron reasoned that if an under-taking lessee is required to report on the basis of its entitled share, then an over-taking lessee is also required to report royalty on that basis. (SOR at 3, 4.) In addition, Chevron asserted that, because it owns no interest in Tract No. 2, which is owned by Nortex, 5/ it is not responsible for the payment of royalty due on production allocated to that lease that exceeds Chevron's entitlement. (SOR at 5.) Further, Chevron denied that it had assumed the obligation by executing the CA or by filing a Payor Information Form (PIF), citing Mesa Operating Limited Partnership (Mesa I), 125 IBLA 28, 99 I.D. 274 (1992). 6/ (SOR at 5-6.)

In her Decision, the Associate Director of MMS rejected the recommendation of the Field Report, and instead held that since December 1, 1982, payors on communitized Federal and Indian leases have been required to report and pay royalty based upon actual volumes taken, as provided by Addendum No. 1 to the MMS Oil and Gas Payor Handbook (Handbook), styled "Reporting Sales and Royalties Based on Actual Rather Than Entitled Quantities." She also noted that the substance of Addendum No. 1

4/ The record initially contained only the first page of the Division Order between Natomas North America, Inc. and Gulf Oil Corp., Appellant's predecessor-in-interest. On Mar. 12, 1999, counsel for MMS supplemented the record with the complete Division Order, which had been signed by Gulf Oil Corp..

5/ See n.2, ante.

6/ It should be noted that the Field Report relied on Mesa II wherein this Board modified Mesa I in part. Mesa I, supra, stands for the proposition that the purchase of production, coupled with the payment of royalties and the filing of a PIF, do not indicate an assumption of the responsibility to pay royalties. Mesa II, supra, affirmed that principle, on reconsideration holding that a division order may constitute evidence of the assumption of the royalty payment obligation.

was subsequently affirmed in a letter to payors issued on January 22, 1992. (Decision at 4-5.) According to the instructions thus issued, reporting on other than a takes basis is appropriate only if all the parties to a gas balancing agreement request authorization to do so in writing, the alternative reporting method is approved by MMS, and the method will ensure that MMS receives the full amount of the royalties due. (Decision at 5.) No such request is contained in the record before this Board.

Thus, the Associate Director found Chevron's reliance on 30 C.F.R. §§ 202.150(e)(2) and 202.150(f) 7/ as support for its contention that royalties are to be paid on an entitlement basis to be misplaced, in that "[t]he cited regulations specify how production taken in excess of entitlements should be valued for royalty purposes in cases where the lessees agree to report and pay on entitlements rather than takes." (Decision at 5.) She similarly found Mesa II, supra, to be inapposite, because Chevron is a lessee and payor, and is contractually obligated to pay royalty, whereas when Mesa I was decided, it appeared to the Board that Mesa had merely purchased and processed production, filed a PIF, and paid royalties to the lessor. The Associate Director stated that Mesa II, supra, holds that in such circumstances, the purchaser has no obligation to the lessor to make any royalty payments. (Decision at 6.) Noting that Pacific and Nortex are equally liable as lessees for the accurate reporting and payment of royalties, the appeals were denied. (Decision at 8, 9.) However, the Decision invited Chevron, Pacific, and Nortex to request a 30-day period in which they could reach agreement on the payment of additional royalties, and thereby avoid duplicate reporting or the need to apply for refunds. (Decision at 9.) The parties apparently did not take advantage of this opportunity.

In its NA, Chevron complains that the Decision failed to address the favorable conclusion that royalty payment on the basis of entitlement was appropriate and the recommendation of the Field Report. Appellant alludes to the Associate Director's recognition that the Order will result in duplicate accounting and an overpayment in arguing that the Order is arbitrary, capricious, an abuse of discretion, and otherwise contrary to law, thus maintaining that it correctly paid royalty based on its entitlement under the CA, 8/ not on the greater volume it took. (NA at 2.)

MMS responds that in reviewing an appeal for the Director, the Associate Director is not bound by the findings of subordinate agency personnel. This is correct. See Xeno, Inc., 134 IBLA 172, 179 (1995). MMS asserts

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7/ It must be noted that it is not clear when or in what document Chevron advanced an argument concerning 30 C.F.R. § 202.150(e)(2) and (f). No such argument is presented in the SOR submitted to the MMS Director or in the NA. Rather, the subsections of the regulation relied on by Chevron are subsections (e)(1) and (e)(4). See SOR at 3-4.

8/ On Dec. 23, 1998, counsel for MMS supplied a copy of the CA with a Motion to Supplement the Record. That Motion is granted.

that, contrary to Chevron's allegation, the Decision did address the recommendation in the Field Report, albeit without mentioning the Field Report by name. (Answer at 2-4.) Although the Decision did not mention the Field Report specifically, there is no question that it fully addressed the conclusions and recommendation contained therein. The Associate Director simply reached a different conclusion.

As to the applicability of Mesa I and II, supra, MMS argues that the Decision properly distinguished this situation from that in the Mesa decisions. (Answer at 5-7.) Lastly, MMS states that the Decision is consistent with the MMS Handbook and the January 22, 1992, Dear Payor letter and applicable law. (Answer at 8-9.) Therefore, MMS contends, the Decision was correct and should be affirmed.

[1] We will begin with the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) before turning to an examination of the provisions of 30 C.F.R. § 202.150(e). MMS is obliged to accurately determine and collect royalty. FOGRMA, 30 U.S.C. § 1711 (1994). That statute further requires a lessee to make royalty payments in the time and manner prescribed by the Secretary, and to notify the Secretary when the lessee makes any assignment of the obligation to make any royalty or other payment. 30 U.S.C. § 1712(a)(1994). FOGRMA additionally provides:

> (k) Volume allocation of oil and gas production
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> (1) Except as otherwise provided by this subsection--
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> (A) a lessee or its designee of a lease in a unit or communitization agreement which contains only Federal leases with the same royalty rate and funds distribution shall report and pay royalties on oil and gas production for each production month based on the actual volume of production sold by or on behalf of that lessee;
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> * * * * * * *
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> (2) This subsection applies only to requirements for reporting and paying royalties. Nothing in this subsection is intended to alter a lessee's liability for royalties on oil or gas production based on the share of production allocated to the lease in accordance with the terms of the lease, a unit or communitization agreement, or any other agreement.
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> (3) For any unit or communitization agreement if all the lessees contractually agree to an alternative method of royalty reporting and payment, the lessees may submit such alternative method to the Secretary or the delegated State for approval and make payments in accordance with such approved alternative method so long as such alternative method does not reduce the amount of the royalty obligation.

30 U.S.C. § 1721(k) (1994) (emphasis added). MMS contends that the requirements of FOGRMA, 30 U.S.C. § 1721(k)(1), are dispositive of Chevron's appeal, an allegation that Appellant has not attempted to rebut. 9/

In 1982, the same year FOGRMA was enacted, MMS issued Amendment No. 1 to its Handbook. 10/ The Amendment, styled "Reporting Sales and Royalties Based on Actual Rather Than Entitled Quantities," unequivocally informed payors that royalty was to be reported on the basis of volumes actually taken, and offered the option of reporting on an entitlement basis, but only if formally requested by all payors that are parties to the gas balancing agreement, and only if the request was approved in writing by MMS. This policy subsequently was affirmed in a Dear Payor letter issued on January 22, 1992, which reiterates that royalty payments for Federal and Indian leases had been based upon "takes" rather than "entitlements" since December 1, 1982. (Attachment K to the Field Report.) The Dear Payor letter was issued well after the regulation here in question was proposed and adopted as final, and thus the record provides a solid interpretive context that Chevron's arguments cannot overcome.

Because of the nature of Chevron's arguments, we will quote 30 C.F.R. § 202.150(e)(1) in its entirety:

> (e)(1) In those instances where the lessee of any lease committed to a Federally approved unitization or communitization agreement does not actually take the proportionate share of the production attributable to its Federal or Indian lease under the terms of the agreement, the full share of production attributable to the lease under the terms of the agreement nonetheless is subject to the royalty payment and reporting requirements of this title. Except as provided in paragraph (e)(2) of this section, the value for royalty purposes of production attributable to unitized or communitized leases will be determined in accordance with 30 CFR part 206. In applying the requirements of 30 CFR part 206, the circumstances involved in the actual disposition

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9/ Sections 6 and 7 of the CA, Article VII. E of the Operating Agreement (Attachment J to the Field Report), the Gas Balancing Agreement (section E of Exhibit E to Operating Agreement), and the Division Order show that the parties remained responsible for the payment of the royalties imposed by their respective leases, copies of which were not in the case file and were not submitted to this Board. We assume that the royalty rate and fund distribution are the same in both leases.
10/ Addendum No. 1 was issued in November 1982, but was amended in December 1982 to provide for unitization and communitization agreements involving both Federal and non-Federal lands. Texaco Inc., 112 IBLA 174, 179, n.6 (1989). The Handbook does not have the force and effect of law. Mesa Petroleum Co., 107 IBLA 184, 192 (1989). In the case at hand, however, Addendum No. 1 and the Handbook mirror applicable statutory requirements.

of the portion of the production to which the lessee was entitled but did not take shall be considered as controlling in arriving at the value for royalty purposes of that portion, as if the person actually selling or disposing of the production were the lessee of the Federal or Indian lease.

(2) If a Federal or Indian lessee takes less than its proportionate share of agreement production, upon request of the lessee MMS may authorize a royalty valuation method different from that required by paragraph (e)(1) of this section, but consistent with the purpose of these regulations, for any volumes not taken by the lessee but for which royalties are due.

(3) For purposes of this subchapter, all persons actually taking volumes in excess of their proportionate share of production in any month under a unitization or communitization agreement shall be deemed to have taken ratably from all persons actually taking less than their proportionate share of the agreement production for that month.

(4) If a lessee takes less than its proportionate share of agreement production for any month but royalties are paid on the full volume of its proportionate share in accordance with the provisions of this section, no additional royalty will be owed for that lease for prior periods at the time the lessee subsequently takes more than its proportionate share to balance its account or when the lessee is paid a sum of money by the other agreement participants to balance its account.

(f) For production from Federal and Indian leases which are committed to federally-approved unitization and communitization agreements, upon request of a lessee MMS may establish the value of production pursuant to a method other than the method required by the regulations in this title if: (1) The proposed method for establishing value is consistent with the requirements of the applicable statutes, lease terms and agreement terms; (2) to the extent practical, persons with an interest in the agreement, including royalty interests, are given notice and an opportunity to comment on the proposed valuation method before it is authorized; and (3) to the extent practical, persons with an interest in a Federal or Indian lease committed to the agreement, including royalty interests, must agree to use the proposed method for valuing production from the agreement for royalty purposes.

(Emphasis added.)

On the one hand, Chevron contends that 30 C.F.R. § 202.150(e) permits it to account for royalty on an entitlement basis, although Pacific and Nortex have accounted on a takes basis. On the other hand, it is argued that Chevron is not the lessee of Tract 2, the lease to which the production in question is allocated, that it has taken no action or agreed to assume Pacific's and Nortex's responsibility to pay royalty, 11/ and hence it cannot be required to pay the royalties due for that portion of unit production attributable to Nortex's lease which Chevron took in excess of Chevron's allocated share. Appellant's interpretation of 30 C.F.R. § 202.150(e) as requiring it to report and pay royalties on an entitlement basis not only ignores applicable provisions of FOGRMA, supra, it necessarily assumes that Chevron is the lessee with respect to the production in question, which it is not.

[2] As an initial matter, 30 C.F.R. § 202.150(e) establishes that the full share of production from a unitized or communitized lease is subject to royalty payment and reporting, and provides a rule for valuing production in a specific context. Second, the regulation contemplates only the situation in which a Federal or Indian lessee participating in approved unitization or communitization agreements takes less than its share of production attributable to its lease, and the production is actually taken by an agreement participant who is not the lessee of the Federal or Indian lease to which the production is allocated under the agreement. In such cases, the agreement participant who takes in excess of its allocated share is deemed a lessee only for purposes of determining the value of that excess production, which must be computed by reference to the actual circumstances of the sale or disposition and in accordance with the provisions of 30 C.F.R. Part 206.

This interpretation is evident from the record of the rulemaking to implement FOGRMA and other statutory authority. 12/ After noting

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11/ See n.8, ante. Section E of the Gas Balancing Agreement also provides "[e]ach party shall pay * * * royalties, overriding royalties, production payments and other such payments for which it is obligated by law or by lease or by contract, and nothing in these gas balancing provisions shall be construed as affecting such obligations." The requirement to value the unit production taken by Chevron above its allocated share as provided in 30 C.F.R. § 202.150(e) and 30 C.F.R. Part 260, and to report and pay royalties on the basis of actual volumes taken by the parties imposed by FOGRMA, does not affect the parties' ultimate responsibility to pay royalties on their allocated shares of unit production in accordance with their agreements.

12/ Notice of proposed rulemaking to amend the gas valuation regulations for gas from the Outer Continental Shelf, Federal onshore leases and Indian Tribal and allotted leases was published at 52 Fed. Reg. 4732 (Feb. 13, 1987). A further notice of proposed rulemaking (FNOPR) was published at 52 Fed. Reg. 30776 (Aug. 17, 1987), and this included MMS' draft of the final regulations as an appendix. The comment period of the FNOPR was extended from Sept. 2, 1987, to Sept. 11, 1987. 52 Fed. Reg. 33247 (Sept. 2, 1987). MMS published notice of its intent to issue a second FNOPR on Sept. 21, 1987, 52 Fed. Reg. 35451, and ultimately did so, appending second draft final rules for comment. 52 Fed. Reg. 39792 (Oct. 23, 1987). These actions culminated in the publication of the final rules at 53 Fed. Reg. 1230 (Jan. 15, 1988).

that Federally-approved unitization and communitization agreements require all production to be allocated, for royalty purposes, to the individual leases subject to the agreement, MMS stated with respect to proposed 30 C.F.R. § 202.150(c), 13/ that in applying the gas valuation provisions of 30 C.F.R. Part 260, "the information pertinent to the person actually taking the production would be used rather than information pertinent to the lessee of the Federal or Indian lease." 52 Fed. Reg. 4732, 4733 (Feb. 13, 1987).

Thus, in the notice adopting 30 C.F.R. § 202.150(e) as a final rule, in response to questions concerning whether the Department was vested with the authority to require "other non-Federal/Indian lessees to pay royalties on leases on which they are not the lessee," and comments on the alleged difficulties of requiring the payment of royalty based upon what other agreement participants received for gas volumes taken, MMS responded as follows:

> Section 202.150(e) of the final rules states that all production attributable to a Federal or Indian lease under the terms of the [unitization or communitization] agreement is subject to the royalty payment and reporting requirements of Title 30 of the Code of Federal Regulations even if an agreement participant actually taking the production is not the lessee of the Federal or Indian lease. * * * Most important, however, § 202.150(e) requires generally that the value, for royalty purposes, of this production [is to] be determined in accordance with 30 CFR Part 206 under the circumstances involved in the actual disposition of the production. As an example, if a Federal lessee does not sell or otherwise dispose of its allocable share of unit production, it will be sold or otherwise disposed of by other unit participants. If one of the unit participants other than the Federal lessee transports unprocessed gas to a sales point off the unit area under an arm's-length transportation agreement and then sells the gas under an arm's-length sales contract, the value, for royalty purposes, will be that participant's gross proceeds less the costs of transportation * * *. This provision does not address the issue of what participant must report and pay the royalties; it only addresses the issue of valuation.
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> These rules do not require non-Federal and non-Indian lessees to conform to these regulations for valuing production. The MMS merely has required that the lessee must determine its royalty liability in accordance with the other interest owners' contracts or proceeds as long as those royalties comply with

13/ Proposed 30 C.F.R. § 202.150(c) was designated 30 C.F.R. § 202.150(d) in the draft final regulations published with FNOPR. 52 Fed. Reg. 30776, 30779 (Aug. 17, 1987). Subsequently, 30 C.F.R. § 202.150(d) was designated 30 C.F.R. § 202.150(e) in the second FNOPR. 52 Fed. Reg. 39792, 39797 (Oct. 23, 1987). The text was not changed.

> these value regulations. Any gas balancing problem that may exist because of interest owners taking more than their entitlement is a matter to be settled by the agreement members.
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> The MMS has added a new paragraph (3) to the final rules to clarify that all agreement participants actually taking volumes in excess of their allocated share of production in any month are deemed to have taken ratably from all persons taking less than their proportionate share. The MMS decided that such a provision was required to provide certainty as to which unit participants' dispositions the lessee must consider to satisfy the requirements of this provision.

53 Fed. Reg. 1234-35 (Jan. 15, 1988) (emphasis added).

[3] To reiterate, with respect to the gas volumes actually taken by Chevron that exceeded its allocable share of production, Chevron is an agreement participant, which, for purposes of the rule governing valuation of this production only, is treated as if it were the lessee of that lease to which the production is attributable. In short, the circumstances of this appeal are precisely those contemplated by 30 C.F.R. § 202.150(e). Contrary to Chevron's contentions, the rule that the value of the production taken by the agreement participant in excess of its allocated share under the CA is to be calculated on the basis of the gross proceeds accruing to the agreement participant from the sale or disposition of the gas, as provided in 30 C.F.R. Part 206, does not affect a lessee's ultimate liability for the payment of royalties on its allocated share of CA production in accordance with the terms of the relevant agreements among the parties. The Decision therefore was correct in concluding that the Mesa decisions, supra, are inapposite because Chevron clearly is contractually obligated to report and pay royalty.

[4] Chevron's argument concerning 30 C.F.R. § 202.150(e)(2) and (f) to which the Decision alludes may have been based upon the single reference to payment of royalties in the first sentence of 30 C.F.R. § 202.150(e)(4), supra. We cannot conclude that the sentence unambiguously states or requires that royalty is to be paid on the lessee's full share, however, as Appellant contends, nor could we, given the applicability of FOGRMA, 30 U.S.C. § 1721(k)(1). Instead, subsection (e)(4) states only that if royalties are paid on the full share "in accordance with the provisions of this section," then no royalties will be paid for subsequent takes that exceed the lessee's share. MMS takes the position that the lessee that takes less than its entitled share at a minimum must pay on its entitled share, observing that there is no need to specify how to value production for royalty purposes where the lessee's takes exceed its entitled share, because the method is the same as the method used for production taken up to the entitled share. (Answer at 8.) As noted, however, Chevron buttresses its interpretation with citations to the preamble to the final

rulemaking. Specifically, in response to industry comments that reporting and paying royalties should be based on total sales from the leases, MMS responded:

> Paying and reporting royalty solely on the basis of sales would not conform to the requirements of the federally approved agreement or the terms of the lease. It also could cause a hardship for Indian lessors who rely on a steady stream of revenues when there is production from their leases. Therefore, it is not an acceptable procedure.

53 Fed. Reg. 1235 (Jan. 15, 1988).

This language at first glance appears to support Chevron's position. It seems to us that the language states nothing more than that in the circumstance addressed by 30 C.F.R. § 202.150(e) -- i.e., the lessees' takes are minimal and another agreement participant is taking virtually all of the production from the leases subject to the agreement -- requiring lessees to pay royalties solely on the basis of sales when there is production from the leases is not acceptable as the exclusive method of valuing production. We find support for this interpretation in Addendum No. 1 itself, which cautioned payors that MMS would monitor gas balancing agreements. In particular, MMS advised that where working interest owners (paying on the basis of actual volumes taken) take substantially less than their entitled share and thus create a significant potential loss or delay of royalty payments, MMS retains the right to require retroactive adjustment or to require future reporting on an entitlement basis.

[5] It is unrefuted that the parties did not avail themselves of the procedure set forth in 30 C.F.R. § 202.150(e)(2) and (f) by which a different valuation method could be employed. In the absence of requesting and obtaining MMS' approval of an alternative method of valuing the production that exceeded Chevron's proportionate share of communitized production, MMS properly required Appellant to submit revised royalty reports to account for the discrepancies in data submitted to the PAAS and the AFS, and to pay additional royalties.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Decision appealed from is affirmed.

T. Britt Price
Administrative Judge

I concur:

Bruce R. Harris
Deputy Chief Administrative Judge